Internal Revenue Service

memorandum

CC:TL-N-2569-89
CLRobertson, Jr.

date: FEB - 6 1989

to: District Counsel, Albany CC:ALB
Attention: Michael Goldbas, Esq.

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [redacted] v. Commissioner, T.C. Docket No. [redacted], reversed and remanded, No. [redacted]

This responds to your request for technical advice dated January 10, 1989, on two issues raised by the petitioners' supplemental motion for litigation costs in the above referenced case.

ISSUES

(1) Whether recovery of litigation costs under I.R.C. § 7430 extends to costs associated with litigating an appeal from the Tax Court's denial of petitioners' motion for litigation costs where the government's position with respect to the appeal is substantially justified and where the case is controlled by Second Circuit precedent. 7430-0000

(2) Whether petitioners are entitled to attorney's fees in excess of the $ 75 per hour ceiling under section 7430 based on an increase in the cost of living and/or based on the limited availability of qualified attorneys for such proceeding in light of Pierce v. Underwood, 108 S.Ct 2541 (1988). 7430-0000

CONCLUSIONS

(1) As stated in our previous technical advice memorandum to you dated November 4, 1988, our position has been that taxpayers should be able to recover all reasonable costs relating to the civil proceeding under section 7430 including the costs of litigating the motion for litigation costs and related appeals. After a review of the recent Tax Court opinion in Powell v. Commissioner, 91 T.C. No. 43 (Sept. 26, 1988), it was decided that we should change our position to be consistent with Powell. However, given the strong and pointed wording of the United States Court of Appeals for the Second Circuit on the same issues

under the Equal Access to Justice Act, we agree that pursuing this position in the Second Circuit venue of this case would not be advisable and will only serve to increase the recovery by the taxpayer in this case of additional attorney's fees.

(2) Attorney's fees in excess of the $75 per hour ceiling set forth under section 7430 (c)(1)(A)(ii)(III) based on an increase in the cost of living shall be computed from the effective date of the amendments to section 7430 which established for the first time under section 7430 the $75 per hour ceiling for attorney's fees. With regard to the second aspect of the issue of a fee in excess of the $75 per hour ceiling based on the argument that the practice of tax law is a specialty constituting a special factor within the meaning of Pierce v. Underwood, 108 S.Ct. 2541 (1988), it is our view that such a construction would effectively erase the $75 per hour ceiling of section 7430 on attorney's fees. We will recommend appeal of a recent Memorandum Sur Order in Estate of Mendel J. Preminger v. Commissioner, T.C. Docket No. 27778-87, December 19, 1988, in which the court concluded that the practice of tax law is a specialty in the law which warrants awarding attorney's fees in excess of the $75 per hour ceiling.

FACTS

The taxpayers in [redacted] received a notice of deficiency based entirely upon partnership items subject to the partnership audit and litigation provisions contained in section 6221, et seq. The case was dismissed for lack of jurisdiction pursuant to an agreed motion. The basis for the dismissal was that pursuant to the partnership provisions of the Code, determinations regarding partnership adjustments can be reviewed by the Tax Court only upon the issuance of a notice of final partnership administrative adjustment. Since such a notice was not issued, there was no basis for a deficiency assessment and the case was dismissed for lack of jurisdiction. The taxpayers then filed a motion for an award of $[redacted] of litigation costs under section 7430. The Tax Court denied the taxpayers' request for litigation costs.

The Second Circuit reversed the Tax Court and granted litigation costs under section 7430 after finding that the taxpayers established that they were the prevailing party because they proved that the position of the United States was not substantially justified. The Second Circuit issued its opinion on [redacted], remanding the case for determination of the reasonableness of the attorney's fees requested by the taxpayers and the entry of an award for litigation costs to the taxpayers in conformity with its opinion.

In reversing the Tax Court, the Second Circuit concluded that once the Service takes a position that leaves the taxpayer no alternative other than a judicial remedy, the Service has taken a position which constitutes "a position of the United States" within the meaning of section 7430. Under the Second Circuit's rationale, it is irrelevant whether the government's position is a litigating position or a final administrative position in which district counsel was not involved. However, section 7430 as amended by the Tax Reform Act of 1986 expressly excludes consideration of prelitigation administrative activity below the level of district counsel.

The Second Circuit's opinion in [redacted] is the [redacted] on this issue in a Tax Reform Act of 1986 case. Two circuits, the Ninth and Sixth Circuits, have suggested in Tax Equity and Fiscal Responsibility Act of 1982 cases, pre-Tax Reform Act of 1986 cases, that they would consider prelitigation administrative activity in determining the position of the United States in a Tax Reform Act of 1986 case. Sliwa v. Commissioner, 839 F.2d 602, 607 n. 6 (9th Cir. 1988); William L. Comer Equity Pure Trust v. Commissioner, slip op. (6th Cir. September 9, 1988). In a letter dated November 22, 1988, the Service informed the Department of Justice that it did not recommend that a petition be filed for certiorari in [redacted] in light of amendments to section 7430 made by the Technical and Miscellaneous Revenue Act of 1988. The letter to Justice noted that there was a possibility for a direct conflict on this issue to develop because at that time an appeal was docketed in the case of Sher v. Commissioner, 89 T.C. 79 (1987), in the Fifth Circuit.

In Sher the Tax Court again agreed with the Service that the "position of the United States" under section 7430 (c)(4) is the position taken by the Service in the litigation proceeding not during the administrative proceeding in a Tax Reform Act of 1986 case. Recently, the United States Court of Appeals for the Fifth Circuit affirmed the Tax Court's view in Sher, 861 F.2d 131 (5th Cir. Dec. 5, 1988). Therefore, there is a direct conflict in the circuits on this point. However, the period for petitioning for a writ of certiorari in [redacted] expired on [redacted] after the Fifth Circuit opinion in Sher was issued on [redacted]. Accordingly, any testing of this conflict will have to result from a taxpayer filed petition in Sher.

ANALYSIS

Issue One

With respect to whether there should be a recovery of litigation costs under section 7430 for the taxpayers' appeal from the Tax Court's denial of their motion for litigation costs, we previously informed you that the National Office had decided that the Service would follow the position taken by the Tax Court in Powell v. Commissioner, 91 T.C. No. 43 (Sept. 26, 1988), that recovery of the appellate costs depended on whether respondent's position with respect to the appeal was "substantially justified". The position was contrary to our historical position which has been that the taxpayer should be able to recover all reasonable litigation costs relating to the civil proceeding under section 7430 including the costs of litigating the motion for litigation costs and related appeals if the taxpayers are vindicated on appeal.

Notwithstanding the decision to follow the position taken by the Tax Court in Powell as a general matter, we agree with your assessment of the precedent in the Second Circuit in cases involving claims under the Equal Access to Justice Act (EAJA), 28 U.S.C. § 2412(d), Pub. L. No. 96-481, 94 Stat. 2321 (1980). A review of Trichilo v. Secretary of Health and Human Services, 832 F.2d 702 (2d Cir. 1987); Trichilo v. Secretary of Health and Human Services, 823 F.2d 702 (2d Cir. 1987); and Parks v. Bowen, 839 F.2d 44 (2d Cir. 1988), indicates the Second Circuit's very strong view that as long as the government's underlying substantive position was not substantially justified, the plaintiff is entitled to recover all reasonable attorney's fees including the appellate fees. The excerpts from the case which you have cited at pages 4 and 5 of your memorandum clearly illustrate the court's view on this issue.

Further, the Second Circuit's opinion in the instant case, [redacted], looked to EAJA for guidance in interpreting the relevant provisions of section 7430. Therefore, arguing that interpretations of a different statute, EAJA, are not controlling for purposes of interpreting this issue in a section 7430 case may not be persuasive before the Second Circuit Court of Appeals. This is particularly so when, as seen under issue two, we are relying on Pierce v. Underwood, 108 8 Ct. 2541 (1988), an EAJA case, as support for our conclusion on the issue of attorney's fees in excess of $75 per hour based on the limited availability of qualified counsel. Pursuing the Powell position in this context would in all likelihood serve only to increase already substantial costs in this case.

We should like to note that informal discussions with the Department of Justice indicate that the Appellate Division informally has taken the view that it is appropriate to examine the separate parts of litigation to determine whether the government's position in each phase was reasonable or substantially justified, contrary to the Second Circuit's view in the cases cited above. Moveover, the availability of favorable precedent in Powell and the fact that section 7430 is in fact a different statute from EAJA, underpin the present decision to depart from our historical view that prevailing parties are entitled to recover all reasonable costs including appellate costs in tax controversies.

Isuue Two

With respect to the issues of whether the attorney's fees in excess of the $75 per hour ceiling based either on an increase in the cost of living or the limited availability of qualified attorneys for such proceedings as described under section 7430(c)(1)(A)(ii)(III), we will first address the issue of increased attorney's fees based on the limited availability of qualified attorneys for such proceeding. Section 7430 provides for the recovery of reasonable litigation costs, including under section 7430(c)(1)(A)(ii)(III):

> Reasonable fees paid or incurred for the services of attorneys in connection with the civil proceeding, except that such fees should not be in excess of $75 per hour unless the court determines that an increase in the cost of living or special factors, such as the limited availability of qualified attorneys for such proceeding, justifies a higher rate. [Emphasis supplied].

As noted in your incoming memorandum requesting technical advice, the Supreme Court in Pierce v. Underwood, 108 S.Ct. 2541 (1988), specifically addressed the issue of attorney's fees under EAJA in excess of the $75 per hour ceiling which limitation exists under EAJA and section 7430. In Part V of its opinion, the Court deals specifically with this issue as follows:

> The EAJA provides the attorney's fees "shall be based upon prevailing market rates for the kind and quality of the services furnished," but "shall not be awarded in excess of $75 per hour unless the court determines that an increase in the cost of living or a special

factor, such as the limited availability of qualified attorneys for the proceedings involved, justifies a higher fee." 28 U.S.C. section 2412 (d)(2)(A)(ii). In allowing fees at a rate in excess of the $75 cap (adjusted for inflation), the District Court relied upon some circumstances that arguably come within the single example of a "special factor" described in the statute, "the limited availability of qualified attorneys for the proceedings involved." We turn first to the meaning of the provision.

If "the limited availability of qualified attorneys for the proceedings involved" meant merely that lawyers skilled and experienced enough to try the case are in short supply, it would effectively eliminate the $75 cap -- since the "prevailing market rates for the kind and quality of the services furnished" are obviously DETERMINED by the relative supply of that kind and quality of services. "Limited availability" so interpreted would not be a "special factor," but a factor virtually always present when services with a market rate of more than $75 have been provided. We do not think Congress meant that if the rates for all lawyers in the relevant city -- or even in the entire country come to exceed $75 per hour (adjusted for inflation), then that market-minimum rate will govern instead of the statutory cap. To the contrary, the "special factor" formulation suggests Congress thought that $75 an hour was generally quite enough public reimbursement for lawyers' fees, whatever the local or national market might be. If that is to be so, the exception for limited availability of qualified attorneys for the proceedings involved" must refer to attorneys "qualified for the proceedings" in some specialized sense, rather than just in their general legal competence. We think it refers to attorneys having some distinctive knowledge or specialized skill needful for the litigation in question -- as opposed to an extraordinary level of the general lawyerly knowledge and ability useful in all litigation. Examples of the former would be an identifiable practice specialty such as patent law, or knowledge of foreign law or language. Where such qualifications are necessary and can be obtained only at rates in excess of the $75 cap, reimbursement above that limit is allowed. For the same reason of the need to preserve the intended effectiveness of the $75 cap, we think the other "special factors" envisioned by the exception

> must be such as are not of broad and general application. We need not specify what they might be, but they include nothing relied upon by the District Court in this case. The "novelty and difficulty of issues," "the undesirablility of the case," the work and ability of counsel," and "the results obtained, " App. to Pet. for Cert. 16a-17a, are factors applicable to a broad spectrum of litigation; they are little more than routine reasons why market rates are what they are. The factor of "customary fees and awards in other cases," id., at 17a is even worse; it is not even a routine reason for market rates, but rather a description of market rates. It was an abuse of discretion for the District Court to rely on these factors. [Emphasis supplied].

It is clear from reading the text of the Court's opinion, that notwithstanding the partial concurrences of Justices Brennan, Marshall and Blackmun in which they disagreed with the Court's view on this issue, that the Supreme Court has interpreted the $75 per hour ceiling in an EAJA proceeding to be a true cap in the absence of extraordinary qualifications of an attorney which would not seem to include just being able to practice tax law and the fact that prevailing market rates for tax attorneys routinely well exceed the $75 per hour limitation. However, it is perhaps unclear how the practice of patent law is an "identifiable practice specialty" entitling it to treatment as a special factor warranting going beyond the $75 per hour limitation, whereas the practice of tax law is not an identifiable practice specialty. It is arguable that tax law is every bit as identifiable and specialized as the practice of patent law.

As noted above, a recent Memorandum Sur Order in Estate of Mendel J. Preminger v. Commissioner, T.C. Docket No. 27778-87, December 19, 1988, held that " tax law is such a specialty as described by the Supreme Court" in Pierce v. Underwood, 108 S.Ct. 22541 (1988). We are recommending that the Preminger Memorandum Sur Order be appealed. Although in extraordinary cases a tax lawyer might be deemed to have the distinctive knowledge or specialized skills needful for the litigation in question, Preminger's blanket conclusion that all tax lawyers who represent prevailing parties in tax controversies should automatically be classified in this category and so entitled to fees in excess of $75 per hour is certainly contrary to the reasoning of the Supreme Court in Pierce v. Underwood.

Requests for litigation costs under section 7430 will generally involve retaining tax counsel since section 7430 pertains to federal tax controversies. Section 7430(a). Thus, if being a tax lawyer is sufficient to warrant an increase in the $75 per hour limitation under section 7430, the statute's $75 per hour limitation is effectively erased. It is especially significant to note that much of these fees in contention are appellate litigation fees. The services rendered in this phase of the proceeding did not pertain to substantive tax issues, much less to tax issues requiring a specialized tax competence. Thus, with respect to these fees the argument for "special factor" status seems very weak.

Rather than attempting to resolve for all time whether tax lawyers should automatically be entitled to be classified as "qualified for the proceedings in some specialized sense," to use the Supreme Court's terminology, it is probably wiser to determine on a case by case basis whether the issues involved in a particular tax controversy are of such extraordinary complexity that they required highly specialized tax competence as opposed to general legal or tax competence. We do not think this was the case in [redacted].

As noted in the statement of the facts, the case involved an invalid notice of deficiency which resulted in the case being dismissed for lack of jurisdiction pursuant to an agreed motion. The basis for the dismissal was that pursuant to the partnership provisions of the Code, determinations regarding the partnership adjustments could be reviewed by the Tax Court only upon issuance of a notice of final partnership administrative adjustment. From that point on in the case the proceeding involved the issue of litigation costs only. In our view the handling of these issues would not require highly specialized tax competence. Therefore, particularly in view of the Second Circuit's disposition to look to EAJA for guidance in interpreting section 7430, we believe the Supreme Court's opinion in Pierce v. Underwood should support our view that granting attorney's fees calculated at more than the $75 per hour ceiling based upon a limited availability of qualified counsel is not warranted in this case.

We would like to specifically note that the supplemental motion for an award of litigation costs submitted by the attorneys for petitioners at page 4, paragraph 11, lists as the basis for its argument that there is present in this case a special factor on the following grounds: the limited availability of qualified counsel, the significance of the issues involved, the novelty and complexity of the issues of first impression

involved in this case, the quality of the representation afforded, and results obtained. As noted in the Supreme Court's Pierce opinion as excerpted above, the Court concluded that "limited availability of qualified attorneys for the proceedings" under EAJA could not mean merely that lawyers skilled and experienced enough to try cases are in short supply. The Court concluded that to so construe this language would in effect erase the $75 per hour cap. The Court also specifically rejected the novelty and difficulty of issues, the work and ability of counsel, and the results obtained as special factors which would warrant lifting the $75 per hour ceiling. In fact, the court concludes that these are little more than "routine" reasons why market rates are what they are.

Indeed, the Second Circuit in Wells v. Bowen, 855 F.2d 37(2d Cir. 1988), in interpreting attorney's fee applications under both the Social Security Act and under EAJA noted at 42:

> [t]he Supreme Court has recently held that the latter clause [a rate of $75 per hour unless the court determines that an increase is justified by an increase in the cost of living or a special factor such as the limited availability of qualified attorneys] allowing an increase...must be interpreted narrowly and can not be read to encompass situations for which normally skilled and qualified attorneys are in short supply.

See Keyava Construction Company v. United States, 15 Cl. Ct. 135 (1988).

With respect to the question of whether the cost of living increases under section 7430 should be computed from the effective date of section 7430 as amended by the Tax Reform Act of 1986, Pub. L. No. 99-514 (1986), or the reenactment or effective dates of the original provision of EAJA or reenacted EAJA, there is no specific legislative history for section 7430 which is specifically dispositive of this issue.

Your memorandum requesting technical advice dated January 10, 1989, correctly notes that the circuits are split as to whether the cost of living increase under the EAJA provision should be measured from the date of enactment of EAJA in 1981 or from the date of reenactment in 1985. In addition to Trichilo v. Secretary of Health and Human Services, 823 F.2d 704 (2d Cir. 1987) (the 1981 date); Herschey v. F.E.R.C., 777 F.2d 5 (D.C. Cir. 1985) (1981 date); Sierra Club v. Secretary of the Army, 820 F.2d 513 (1st. Cir. 1987) (1981 date); Chipman v. the Secretary

of Health and Human Services, 781 F.2d 545 (6th Cir. 1986) (1985 date), the Claims Court has ruled on this issue in the EAJA context, Keyava Construction Company v. United States, 15 Cl. Ct. 135 (July 7, 1988) (the 1981 date). See also Allen v. Bowen, 821 F.2d 963 (3d Cir 1987); Faulkner v. Bowen, 673 F. Supp. 1549 (1987); Baker v. Bowen, 839 F.2d 1075 (March 14, 1988); Sierra Club v. Marsh, 639 F. Supp. 1216 (D.Me. 1986), aff'd, 820 F.2d 513 (1st. Cir. 1987); Jackson v. Heckler, 629 F. Supp. 398 (S.D.N.Y. 1986) Carrion v. Barven, 83-4115 (E.D.Pa. November 21, 1986) [all for the 1981 date]. As can be seen from citations the great majority of the federal courts that have spoken on this issue in the EAJA context have held that the earliest date applicable under EAJA should be the date from which the cost of living adjustment is to be measured.

Notwithstanding the fact that section 7430 grew conceptually out of EAJA, the two are separate statutes. The enacting statute of section 7430, section 292 (c) of TEFRA specifically pre-empted the operation of EAJA in all federal tax cases brought in any federal court on or after March 1, 1983. Moreover, you correctly note that section 7430 was not even in effect as of the effective date of the original EAJA provision in 1981. Perhaps more importantly, as originally enacted in 1982, section 7430 contained a $25,000 limitation on litigation cost awards. The $75 per hour ceiling did not replace the $25,000 limitation on section 7430 until the amendments made by the Tax Reform Act of 1986, Pub. L. No. 99-514 (1986) almost four years later. Your citation to Wells v. Bowen, 855 F.2d 37, at 43 (2d Cir. 1980): "[w]hen a statute calls for award of reasonable fees, the District Court, in determining the prevailing market rate, may not simply rely on specific hourly rates mandated by other statutes, such as EAJA..." indicates that the Second Circuit itself understands that different statutes may require different standards and implicitly different computational dates for determining the amount of the attorney's fees. Finally, Congress could have easily raised the $75 cap to reflect the inflation that had occurred subsequent to the original enactment or the reenactment of EAJA when it amended section 7430 to include the $75 per hour limitation in 1986.

Therefore, notwithstanding the precedents in the federal courts on this issue in an EAJA context and in view of the foregoing, we agree that any cost of living adjustment should be measured from the effective date of the Tax Reform Act of 1986 provision which established for the first time under section 7430 the $75 per hour limitation and repealed the $25,000 ceiling which previously existed under section 7430 as enacted by TEFRA in 1982.

Please call Calder Robertson (FTS 566-4189) if you have any further questions on these issue.

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